E-017/M-91-457 ORDER ESTABLISHING DEMAND SIDE MANAGEMENT INCENTIVE PILOT PROJECT AND REQUIRING FURTHER FILINGS

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Don Storm	Chair
Cynthia A. Kitlinski	Commissioner
Dee Knaak	Commissioner
Norma McKanna	Commissioner

In the Matter of the Proposal of Otter Tail Power Company for a Demand-Side Management Financial Incentive

ISSUE DATE: March 12, 1992

DOCKET NO. E-017/M-91-457

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PROCEDURAL HISTORY

I. Proceedings to Date

On February 28, 1991 the Commission issued an Order requiring all investor-owned electric utilities serving more than 500 Minnesota customers to file plans for financial incentives to promote demand side management. In the Matter of a Summary Investigation into Financial Incentives for Encouraging Demand-Side Resource Options for Minnesota Electric Utilities and Bidding Systems, Docket No. E-999/CI-89-212, ORDER REQUIRING ELECTRIC UTILITIES TO FILE FINANCIAL INCENTIVE PROPOSALS IN 1991 (February 28, 1991). On October 1, 1991 Otter Tail Power Company (Otter Tail or the Company) filed its demand side management incentive proposal.

The Department of Public Service (the Department) and the Residential Utilities Division of the Office of the Attorney General (RUD-OAG) filed comments. The RUD-OAG supported the Company's proposal. The Department supported it with modifications.

The matter came before the Commission on February 5, 1992.

FINDINGS AND CONCLUSIONS

II. The Company's Proposal

The Company proposed a three part financial incentive. First, the Company proposed to add a monthly carrying charge to its Conservation Improvement Program (CIP) tracker account. CIP tracker accounts record actual CIP collections and expenditures to ensure dollar for dollar recovery, as opposed to test year treatment, at ratemaking time. In the past, Otter Tail had forgone carrying charges on its CIP tracker balance. The Company now proposed to add carrying charges because new legislation had increased its CIP spending requirements substantially. Minn. Stat. § 216B.241, subd. 1a (Supp. 1991).

Second, the Company proposed full recovery of all margins lost due to energy savings achieved through successful CIP projects. For administrative simplicity, lost margins were defined as the difference between lost revenue and related cost reductions.

Finally, the Company proposed that it be awarded a one-time "bonus" for each kWh saved. The amount of the bonus would be determined along a sliding scale tied to Company success in meeting its CIP goals. The bonus would range from nothing, at a 49% success rate, to two cents at a 50% success rate, to four cents at a 100% success rate.

III. Parties' Comments

The Department recommended approving a modified version of the Company's proposal as a two-year pilot project. The Department had technical objections to the Company's proposal for quantifying lost margins for the residential class and recommended using the margins built into the Company's residential tariffs instead. The Department supported the Company's proposed method for commercial and industrial customers, as long as revenues from customer charges were excluded.

The Department recommended combining the Company's lost margins recovery proposal with its bonus proposal to make a single financial incentive. Under the Department's proposal, the Company would recover lost margins along a sliding scale corresponding with its success in achieving its CIP goals. If the Company's success rate was 49% or lower, the Company would recover no lost margins. If the success rate was 100%, the Company would recover all lost margins. If the success rate exceeded 100%, the Company could recover up to 150% of lost margins, depending upon its performance.

Finally, the Department recommended requiring the Company to file a detailed plan for measuring energy savings, and a plan for evaluating the effectiveness of the pilot project, within 30 days.

The RUD-OAG generally supported the Company's proposal, but had reservations about the proposed size of the bonus if Otter Tail achieves only 50% of its CIP goals. The RUD-OAG also questioned the appropriateness of a four cent per kWh bonus, since that amount would exceed the Company's currently authorized rate of return. The RUD-OAG recommended either deferring action on the four cent bonus until the end of the pilot project or capping the bonus at an 11 or 11.5 percent return on conservation investment.

IV. Commission Action

A. The Statutory Standard

The Public Utilities Act authorizes the Commission to require utilities to develop financial incentives for demand side management and requires the Commission to consider the following factors in evaluating those plans:

(1) whether the plan is likely to increase utility investment in cost-effective energy conservation;

(2) whether the plan is compatible with the interest of utility ratepayers and other interested parties;

(3) whether the plan links the incentive to the utility's performance in achieving cost-effective conservation; and

(4) whether the plan is in conflict with other provisions of the Public Utilities Act.

Minn. Stat. § 216B.16, subd. 6c (Supp. 1991).

B. The Appropriateness of Financial Incentives

The role of demand side management financial incentives in Minnesota regulation is still evolving. Legislation enacted in 1991 allows the Commission to approve financial incentives; it does not require the Commission to do so. That legislation also requires substantial investments in demand side management by all Minnesota utilities. Minn. Stat. § 216B.241, subd. 1a and 1b (Supp. 1991). There is a certain anomaly in giving utilities financial incentives to comply with the law.

On the other hand, financial incentives may increase the quality and quantity of utilities' demand side efforts, producing the significant energy savings the Act aims to achieve. Requiring utilities to spend specified amounts of money on conservation is one thing; harnessing their creativity on behalf of conservation is another. The Commission believes that financial incentives may be an effective tool for encouraging utilities to do more than comply with statutory spending requirements, to focus their creative energies on conservation.

The Commission concludes that it is in the public interest to establish financial incentives for Otter Tail to invest in demand side management. By doing this, the Commission is not finding that financial incentives are in the public interest and should become a permanent part of electric utility ratemaking. It may turn out that financial incentives are useful primarily as devices to ease the transition from supply side management to a combination of supply side and demand side management. It may turn out that the role of financial incentives should be limited to encouraging utilities to find and implement the most cost effective conservation programs possible. For now, however, the Commission is convinced it is in the public interest to explore the potential of incentive programs designed by individual utilities to increase their individual use of demand side management.

C. Carrying Charge on the CIP Tracker Account

The Commission agrees with all parties that it is appropriate for the Company to begin adding carrying charges to its CIP tracker account. The purpose of the CIP tracker account is to ensure complete recovery of actual CIP expenditures, as opposed to the classic ratemaking approach of limiting recovery to representative test year expenses. Allowing carrying charges is consistent with this purpose, since carrying charges will compensate the Company for the time value of the money invested in CIP projects.

D. Full Recovery of Lost Margins

The Department urged the Commission to tie Otter Tail's recovery of lost margins to achievement of its CIP goals. The Department is rightly concerned with performance; two of the four factors the statute requires the Commission to consider in acting on incentive proposals deal with performance. The Commission believes, however, that for purposes of this pilot project, limiting recovery to margins actually lost due to conservation adequately ties recovery to performance. Only when energy has been saved will the Company recover lost margins.

Furthermore, allowing recovery of lost margins really amounts to little more than eliminating the obstacle of regulatory lag to encourage conservation. The Company could file annual rate cases and accomplish the same thing. It can be argued that this is what the Company should do, since the general rate case is the natural vehicle for adjusting rates to reflect changes in sales volumes. It can also be argued that it would be unduly harsh to require the Company to file a general rate case to be made whole for losses it is required to incur by law and public policy. Both arguments have merit. The Commission is convinced, however, that at this stage in the effort to promote heavier reliance on demand side management, it makes sense to remove the obvious obstacle of lost margins.

The Commission finds that recovery of lost margins is in the public interest, is consistent with the standards set forth at Minn. Stat. § 216B.16, subd. 6c (Supp. 1991), and should be approved.

E. Bonus for Saved kWh

In principle, the Commission approves of the Company's proposal for a one-time bonus for each kWh saved by its CIP program. A bonus system is a very direct approach to encouraging targeted behavior. It is easy to understand and easy to administer. It makes sense to experiment with bonuses in a pilot project like this one. At the same time, the Commission agrees with the Department and the RUD-OAG that the bonus levels proposed by the Company are probably more generous than they need to be. The Commission will therefore adjust the bonus levels proposed by the Company and approve the bonus proposal as modified.

First of all, conservation is an important public policy to which utilities are expected to be committed. It is just as reasonable to penalize substandard conservation performance as it is to reward satisfactory or outstanding performance. The Commission will therefore establish symmetrical bonuses and penalties, tied to kWh saved through cost-effective programs. In order to ensure the cost-effectiveness of programs, the Company will be required to achieve at least 50% of its net avoided revenue requirements goal before it is eligible to receive a bonus.

The applicable bonus or penalty will be determined based on the Company's performance in meeting its CIP goals. The bonus will begin at zero for 50% achievement and range linearly up to two cents per kWh saved for achievement at the 100% or greater level. If the Company's performance falls below 50%, it will be subject to a similar penalty, beginning at zero and ranging to a maximum penalty of 0.4 cents per kWh at achievement of 40% or less of goals. The Commission finds that capping the Company's potential liability at 0.4 cents is an appropriate limitation of risk for a pilot project.

The Commission finds, applying the statutory considerations and its own expertise, that this bonus/penalty incentive is in the public interest and should be adopted. The incentive is likely to increase investment in cost-effective energy conservation; it is compatible with the interests of ratepayers and other interested parties; it links the incentive with performance in achieving cost-effective conservation; it does not conflict with other provisions of the Public Utilities Act. Minn. Stat. § 216B.16, subd. 6c (Supp. 1991).

F. Reporting and Evaluation Requirements

The Commission agrees with all parties that it would promote administrative efficiency to examine lost margin calculations in conjunction with the Company's annual CIP evaluation filing. The Commission will therefore require the Company to file its calculations of lost margins and applicable bonuses or penalties annually on April 1.

This incentive proposal is being approved as a two year pilot project. To ensure meaningful data at the end of the two-year period, it is important to have a workable plan for evaluating the project's results. The Commission will require the Company to file a plan for evaluating the success of the pilot project within 45 days of the date of this Order.

Similarly, to avoid as many future conflicts as possible, it is important to have a working understanding of how lost margins attributable to conservation will be measured. The Commission will therefore require the Company to file a proposal for measuring lost margins within the same 45 day period.

ORDER

1. Otter Tail Power Company's financial incentives proposal, as modified above, is approved as a two year pilot project.

2. Within 45 days of the date of this Order, the Company shall file a plan for measuring lost margins attributable to conservation and a plan for evaluating the financial incentives pilot project.

3. Any party wishing to file comments on the Company's plan for measuring lost margins or its plan for evaluating the pilot project shall do so within 30 days of the Company's filing.

4. The Company shall file its calculations of lost margins and applicable bonuses or penalties annually on April 1.

5. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Richard R. Lancaster
Executive Secretary

(S E A L)